

December 8, 2006

The Honorable Sarah Palin, Governor
Members of the Alaska State Legislature
Alaska Retirement Management Board
Employers and Plan Members

We are pleased to present the Comprehensive Annual Financial Report (CAFR) of the Public Employees' Retirement System (PERS) (Plan) for the fiscal year ended June 30, 2006.

This report is intended to provide comprehensive information on the financial operations of the Plan for the year. Responsibility for the accuracy, completeness and fairness of the information presented rests with the management of the Plan. To the best of our knowledge and belief, the enclosed information is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the Plan for the year ended June 30, 2006. All disclosures necessary to enable the reader to gain an understanding of the Plan's activities have been included.

For financial reporting purposes, the Plan utilizes Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*; GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*; GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*; GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, GASB Statement No. 40, *Deposits and Investment Risk Disclosures*, and GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*. Assets of the Plan are presented at fair value. The actuarial value of assets and the actuarial accrued liability are presented in the required supplementary information following the notes to the financial statements.

The CAFR is divided into five sections:

- **Introductory Section**, which contains this letter of transmittal, the administrative organization of the Plan, and a list of the members serving on the Alaska Retirement Management Board;
- **Financial Section**, which contains the Independent Auditors' Report, management's discussion and analysis (MD&A), basic financial statements, required supplementary information, and additional information;
- **Investment Section**, which contains a report prepared by the investment consultant, a report on investment activity, investment results, and various investment schedules;
- **Actuarial Section**, which contains the Actuarial Certification letter and the results of the most current annual actuarial valuation; and
- **Statistical Section**, which includes additional information related to financial trends, demographic and economic information, and operating information.

The MD&A provides an analytical overview of the basic financial statements. This Letter of Transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A is located in the Financial Section of this report immediately following the Independent Auditors' Report.

The PERS was established in 1961 to provide pension and postemployment healthcare benefits for eligible state and local government employees. Normal service, survivor, and disability benefits are available to all members who attain the Plan's age and service requirements. During the fiscal year 2005 legislative session, a law was enacted that closes the Plan. Senate Bill 141, signed into law on July 27, 2005, closes the Plan effective July 1, 2006, to new members and creates a defined contribution retirement plan for members first hired on or after July 1, 2006. Beginning in fiscal year 2007, the PERS will consist of two retirement plans, the defined benefit plan and the defined contribution plan.

	Years Ended June 30		
	2006	2005	2004
Net Assets (millions)	\$9,379.5	8,590.8	8,177.3
Participating Employers	160	160	161

Reporting Entity

The Plan is considered a component unit of the State of Alaska for financial reporting purposes. Because of the closeness of the Plan's relationship to the State, it is included in the State of Alaska CAFR as a fiduciary fund.

The Commissioner of the Department of Administration, appointed by the Governor, is responsible for administering the Plan. In order to meet the statutory requirements of administering the Plan, the Commissioner appoints the Director of the Division of Retirement and Benefits. The Director is responsible for the daily operations of the Plan.

The Alaska Retirement Management Board (ARMB) constituted effective October 1, 2005, replaced the Public Employees' Retirement Board (effective July 1, 2005) and the Alaska State Pension Investment Board (ASPIB) (effective October 1, 2005). Prior to October 1, 2005, the ASPIB had statutory oversight of the Plan's investments and the authority to invest the Plan's financial resources.

The ARMB is responsible for:

- adopting investment policies and developing investment objectives;
- providing a range of investment options and establishing the rules by which participants can direct their investments among those options, when applicable;
- establishing crediting rates for members' individual contribution accounts, when applicable;
- assisting in prescribing policies for the proper operation of the PERS;
- coordinating with the PERS Administrator to have actuarial valuations performed;
- reviewing actuarial assumptions and conducting experience analyses;
- contracting for an independent audit of actuarial valuations and external performance calculations; and
- reporting to the governor, legislature and individual employers participating in the PERS on its financial condition.

Major Initiatives

The Public Employees' Retirement Board (governing board prior to July 1, 2005) looked at ways to reduce costs to the employers and address the unfunded status of the PERS while also balancing the need to provide adequate benefits in order to effectively recruit and retain new members. Senate Bill 141 passed during the 2005 legislative session created Tier IV in the PERS. This new tier, a hybrid plan referred to as the defined contribution retirement plan, becomes effective for members entering the PERS on or after July 1, 2006. The PERS administrator is working with legal counsel to obtain plan qualification and various private ruling letters related to the new tier.

The PERS continues to make progress on several ongoing projects. Most of these efforts focused on improvements in technology, improving methods for employers to submit information, improving methods for members to obtain information, and continued compliance with accounting requirements of the GASB and the Financial Accounting Standards Board (FASB) as applicable.

Independent Audit

The PERS annual audit was conducted by the independent accounting firm of KPMG LLP. The auditors' report on the basic financial statements is included in the Financial Section of this report.

Investments

At June 30, 2006, the Plan's investment portfolio was valued at \$9.4 billion and earned an 11.74% return for the fiscal year ended June 30, 2006. Over the past five years ending June 30, 2006, the Plan's investments earned a 6.54% return. The ARMB has statutory oversight of the Plan's investments and the Department of Revenue, Treasury Division, provides staff for the ARMB. Actual investing is performed by investment officers in the Treasury Division or by contracted external investment managers. The ARMB reviews and updates investment policies and strategies and is responsible for safeguarding invested assets.

Internal Controls

Plan internal accounting controls are designed to reasonably assure the safekeeping of assets and the reliability of financial reporting. Control procedures are the responsibility of the Plan's management. The independent auditors do not express an opinion on the effectiveness of the internal controls.

Actuarial Valuation

The actuarial firm, Buck Consultants, completed the actuarial review and valuation as of June 30, 2005, and served as technical advisor to the PERS. An actuarial certification and supporting statistics are included in the Actuarial Section of this report.

Professional Services

Professional consultants are retained to perform professional services that are essential to the effective and efficient operation of the PERS. A list of consultants is provided in the Introductory Section with the exception of investment professional consultants, who are listed in the Investment Section of this report.

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the PERS for its CAFR for the fiscal year ended June 30, 2005. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. This report must satisfy both U.S. generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year. We are confident our current CAFR continues to meet the Certificate of Achievement Program's requirements. Therefore, we are submitting it to the GFOA for consideration.

Future Employer Contribution Rates

The PERS' consulting actuary presented the results of the June 30, 2005, actuarial valuation report to the Plan Administrator and the ARMB. The assumptions and benefits are explained in the Actuarial Section of this report.

Based on the most recent valuation report, the PERS has a funding ratio (actuarial value of Plan assets divided by actuarial liabilities for pension and postemployment healthcare benefits) of 65.7%. The unfunded portion of the Plan's liabilities totals approximately \$4.4 billion. The unfunded liability is amortized over a 25-year fixed period, as established by the ARMB. In order to bridge the gap between assets and liabilities, the employer contribution rate is projected to increase over the same 25-year period, if the Plan's actual experience agrees with the assumptions underlying the valuation. The current asset allocation that the ARMB set for the Plan's investments is expected to provide a five-year median return of 7.83%.

There are three primary factors that have contributed to the Plan's current funding ratio: (1) loss of investment income in fiscal years 2001 and 2002; (2) rising healthcare costs; and (3) change in assumptions. These factors have negatively impacted the funding ratio for PERS and resulted in increasing employer contribution rates.

Currently, the PERS is among the few retirement systems that pre-fund and account for healthcare costs. The PERS is fortunate in that the creators and administrators had foresight to fund healthcare costs in advance. Most other major governmental retirement systems account for their healthcare costs on a pay-as-you-go basis. Implementation of GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans*, will be phased in beginning with the largest systems (including the PERS) implementing in fiscal year 2007. This Statement requires disclosures related to healthcare costs similar to those currently required for pension costs. Once implemented, all systems will account for their future healthcare costs making comparisons between systems more meaningful.

Acknowledgments

The preparation of this report is made possible by the dedicated service of the staff of the Department of Administration, Division of Retirement and Benefits and the Department of Revenue, Treasury Division. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means of determining responsible stewardship of the PERS' financial resources.

The report is available on the web at www.state.ak.us/drb/pers/perscafr.shtml and mailed to those who submit a formal request. This report forms the link between the PERS and the membership. The cooperation of the membership contributes significantly to the success of the PERS. We hope the employers and plan members find this report informative.

We would like to take this opportunity to express our gratitude to the Alaska State Pension Investment Board, the Alaska Retirement Management Board, the staff, the advisors, and to the many people who have worked so diligently to assure the successful operation of the PERS.



Kevin Brooks
Acting Commissioner



Melanie Millhorn
Deputy Commissioner



Christina Maiquis
Accounting Supervisor

Respectfully submitted,



Traci Carpenter
Director



Charlene Morrison, CPA
Chief Financial Officer

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Alaska

Public Employees' Retirement
System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



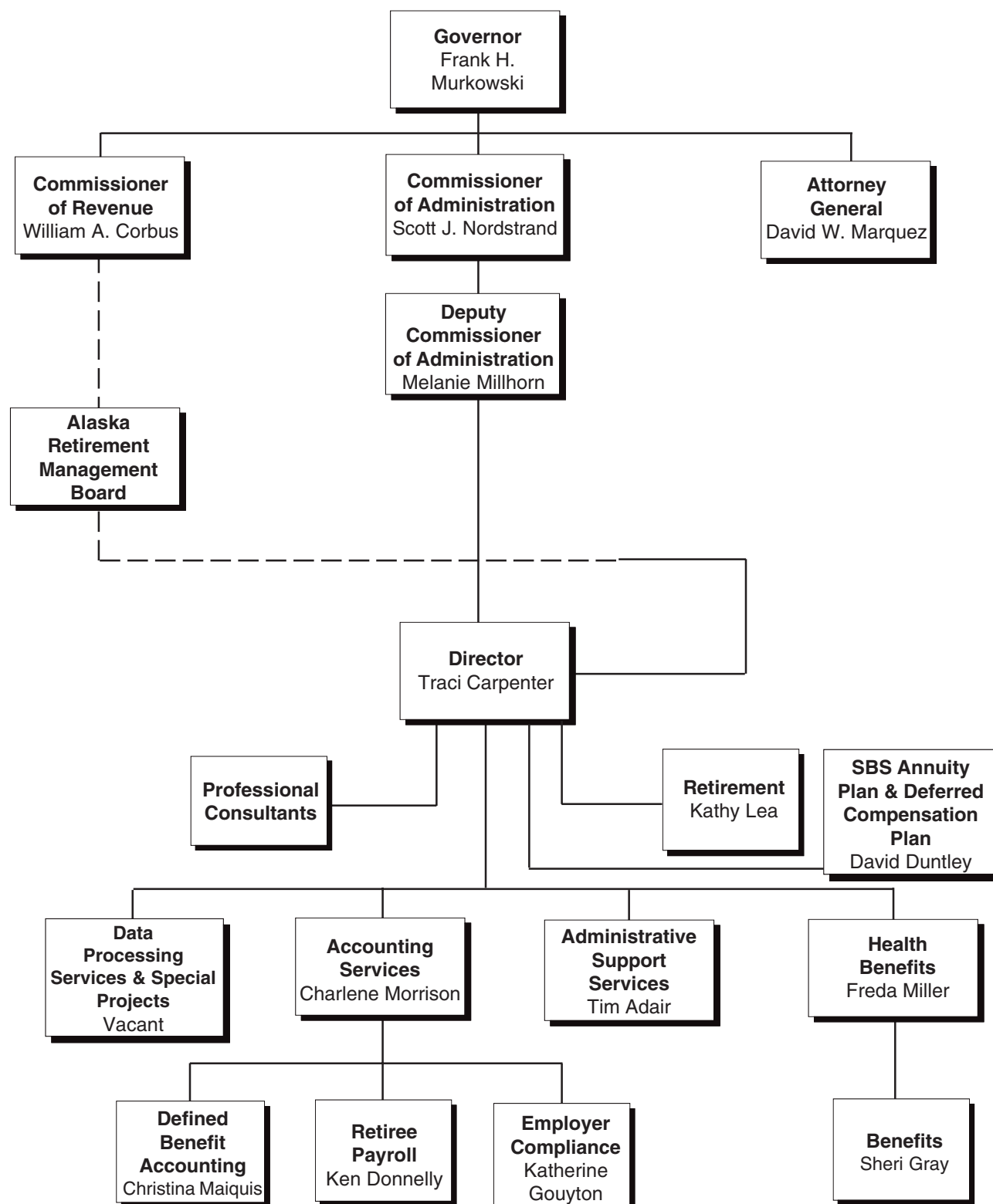
Carla E. Perry

President

Jeffrey R. Emer

Executive Director

ORGANIZATION CHART



Section Responsibilities

The **Retirement Section** is responsible for providing comprehensive retirement counseling to the participating members and employers in the plan. This section appoints members to retirement benefits and maintains benefit payment information.

The **Health Benefits Section** is responsible for the administration of health, disability, and life insurance. This section provides benefits counseling and plan change information to the membership.

The **Accounting Services Section** is responsible for maintaining the employee and employer records and accounts in each of the defined benefit plans administered by the Division, producing financial statements and reports, and assuring compliance with the Internal Revenue Service requirements for defined benefit plans.

The **SBS Annuity Plan and Deferred Compensation Plan Section** is responsible for accounting, plan operations, and financial activities related to the SBS Annuity and Deferred Compensation Plan administered by the Division.

The **Data Processing Services Section** supports the information systems the System uses. Responsibilities include planning, development, data base design, programming, and operational support of the data processing systems, including the Local Area Network.

The **Administrative Support Services Section** is responsible for budget preparation, fiscal management of appropriations, procurement of professional services, supplies, and equipment. The section manages the systems' record center containing the member's physical records and performs other administrative functions such as legislative tracking and personnel management.

PROFESSIONAL CONSULTANTS

Consulting Actuary

Buck Consultants
Denver, Colorado

Independent Auditors

KPMG LLP
Anchorage, Alaska

Benefits Consultant

Buck Consultants
Denver, Colorado

Third-Party Healthcare Claim Administrator

Aetna Life Insurance Company
Walnut Creek, California

Legal Counsel

Virginia Ragle
Toby Steinberger
Assistant Attorney Generals
Juneau, Alaska
Ice Miller LLP
Indianapolis, Indiana

Legal Counsel - Retirement Boards

Wohlforth, Johnson, Brecht, Cartledge & Brooking
Anchorage, Alaska

Consulting Physicians

Kim Smith, M.D.
William Cole, M.D.
Juneau, Alaska

A list of investment consultants can be found on pages 59-60 and on the Schedule of External Management Fees on pages 68-69.

ALASKA RETIREMENT MANAGEMENT BOARD

The Alaska Retirement Management Board (ARMB) replaced the Public Employees' Retirement Board (effective July 1, 2005) and the Alaska State Pension Investment Board (effective October 1, 2005). At June 30, 2006, the ARMB was made up of nine members appointed by the Governor.

Gail (Anagick) Schubert, Chair, is the Executive Vice President and General Counsel for the Bering Straits Native Corporation, and President/CEO of several of its subsidiary entities. She is an attorney licensed to practice law in the states of Alaska and New York. Ms. Schubert serves as Chair of the Alaska Native Heritage Center, Chair of Akeela Treatment Services, Vice Chair of the Alaska Native Justice Center, Vice Chair of Khoanic Broadcast Corporation, Treasurer of the Bering Straits Native Corporation, and as a board member of the Alaska Federation of Natives, and the Alaska Native Arts Foundation. She is also a member of the Alaska Rural Justice and Law Enforcement Commission. Ms. Schubert received her undergraduate degree from Stanford University, and holds a Law Degree and Masters Degree in Business Administration from Cornell University.

Sam Trivette, Vice-Chair, is currently President of the Retired Public Employees of Alaska, and is on the national executive board of the American Federation of Teachers retirees. Mr. Trivette retired from public service after more than 32 years serving as Chief Probation Officer, Director of Community Corrections, Executive Director of the Parole Board, and as a probation and correctional officer. He is President of Quality Corrections Services, and on the board of directors of the Alaska Public Employees Association. Mr. Trivette has also served as an officer in a number of national and statewide professional organizations as well as many not-for-profit organizations around Alaska. He has a B.A. in Psychology from the University of Alaska, Anchorage and has completed postgraduate work in public administration, law and psychological counseling.

Gayle W. Harbo, Secretary, retired after teaching mathematics in Fairbanks for 25 years. She also served as math department chair, as advanced placement coordinator, on the district curriculum, evaluation and budget committees, and twice as chair of the Lathrop Self-Evaluation for Accreditation Committee. Ms. Harbo is a member of Alpha Delta Kappa, AARP, National Retired Teachers of Alaska, Fairbanks Retired Teachers Association, National Council of Teacher Retirement Systems, NCTR Education Committee, and the Alaska Teachers' Retirement Board. She is also a co-manager of a family trust. Ms. Harbo was named Alaska Teacher of the Year in 1989. She holds a B.S. in Mathematics from North Carolina State University, and a Masters in Teaching from the University of Alaska, Fairbanks, and has completed an additional 40 hours in mathematics, counseling, law and finance.

William Corbus was appointed Commissioner of the Department of Revenue in December 2002. He oversees an agency that has very diverse responsibilities, including tax collection, investing state funds, child support enforcement and distributing permanent fund dividends. Bill Corbus is the retired president of Alaska Electric Light and Power, the electric company that serves the Juneau area, where he has lived since 1970. He served as a Lt. J.G. in the U.S. Naval Reserve, including one year as an advisor to the Vietnamese Navy in 1962-63. Mr. Corbus then worked for Stone & Webster in New York City providing public utility security analysis, financial planning, and accounting. The Commissioner sits on nine boards, including the Board of Trustees of the Alaska Permanent Fund Corporation. Mr. Corbus holds a B.S. in Industrial Engineering from Stanford University and an MBA from the Amos Tuck Graduate School of Business Administration at Dartmouth College.

Scott Nordstrand, Commissioner of Department of Administration was appointed commissioner in 2005. He is an attorney and previously served as deputy attorney general for the civil division in the state Department of Law. Prior to his state service, Commissioner Nordstrand served for 15 years as an attorney in private practice in Anchorage primarily focusing on employment and commercial litigation. He received his Bachelor's Degree in Political Science from the University of Wisconsin and a Law Degree from the University of North Dakota School of Law.

Martin Pihl came to Alaska in 1962 to work for Ketchikan Pulp Company, becoming President and General Manager in 1987 until his retirement in 1994. He then served as Acting Executive Director for the Alaska Permanent Fund Corporation in 1994-1995. Mr. Pihl serves as a director of National Bank of Alaska and on Wells Fargo Bank's Alaska Statewide Advisory Board, as Chairman of the Board of Governors of the Alaska Timber Insurance Exchange, and as a regent for Pacific Lutheran University. He is also a member of several advisory boards including Holland America-Westmark-Ketchikan Advisory Board, Ketchikan Ports and Harbors Advisory Board, and Alaska Airlines Southeast Alaska Community Advisory Board. Mr. Pihl holds a B.A. in Accounting from the University of Washington and has been a CPA since 1958.

Larry Semmens is currently the Finance Director of the City of Kenai where he has been employed since 1996. Mr. Semmens started his career with Price Waterhouse and Co. in Anchorage in 1980, then worked in the Kenai Peninsula Borough finance department for 15 years in various positions, including finance director, prior to moving to Kenai. He is a past president of the Alaska Government Finance Officers Association, Vice-Chair of the Alaska Public Entities Insurance Pool Board, and Chair of the Aurora Borealis Charter School Board. Mr. Semmens is a certified public accountant and a U.S. Air Force Veteran. He holds a B.B.A. in Accounting from Boise State University.

Michael R. Williams is currently a Revenue Auditor for the Alaska Department of Revenue, performing audits of large, multi-state and multi-national corporations since 1998. He is also a partner and principal owner of Williams & Payne, LLC, a tax preparation and consultation business in Anchorage. Mr. Williams has also worked as a tax consultant for Deloitte & Touche and as a tax auditor for the State of Utah. He has served as Secretary for ASEA/AFSCME Local 52, as trustee for the ASEA Health Benefits Trust, and is a member of the National Association of Enrolled Agents. Mr. Williams holds a B.A. in Accounting & German and a Master of Professional Accountancy from Weber State University.